

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
REPLY BRIEF**

75 4214

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 75-4214

CHARLES G. RODMAN, as Trustee of the
ESTATE OF W. T. GRANT COMPANY, Bankrupt,

Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

ON APPEAL FROM A DECISION OF THE UNITED STATES
TAX COURT

REPLY BRIEF FOR THE APPELLANT

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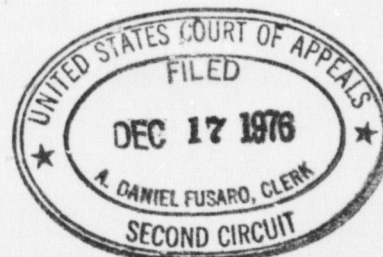


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REPLY BRIEF FOR THE APPELLANT

INTRODUCTION

The Commissioner concedes^{1/} "for purposes of argument" that (1) ¶2(b)(2)^{2/} encompasses non-traditional installment plans other than revolving credit plans,^{3/} and (2) the Grant coupon book installment plan is one such non-traditional installment plan that is not a revolving credit plan [hereafter, a

1/ Commissioner's Br. 9-10, 25-26.

2/ Regulations, §1.453-2(b)(2).

3/ As to this matter (the scope of ¶2(b)(2)), the Commissioner's concession appears to be complete rather than merely "for argument." See the carryover sentence, bottom of 25 - top of 26, in the Commissioner's brief.

"¶2(b)(2) plan"]. He asserts, however, that the Trustee nonetheless must fail in this appeal for impossibility of proof.

Specifically, the Commissioner contends^{4/} to establish that sales under a ¶2(b)(2) plan qualify as "sales on the installment plan," the regulations permit only two modes of proof. According to the Commissioner, a retail dealer may use only the detailed, special ¶2(d) proof rules^{5/} or the retail dealer

may literally satisfy the terms of ¶2(b)(2) by establishing as to each sale that the "(i) ... plan, by its terms and conditions, contemplates ... such sale will be paid for in two or more payments, and (ii) ... [that the] sale is in fact paid for in two or more payments" ((¶2(b)(2))). ^{6/}

[Emphasis supplied]

Recognizing that, as a matter of commercial feasibility, neither Grant nor any other volume retailer can shoulder a sale-by-sale proof burden, the Commissioner concludes that the regulations in reality afford the non-traditional plan retailer only one method of proof: proof pursuant to the detailed, special proof rules of ¶2(d).^{7/}

^{4/} Commissioner's Br. 12, 32-33, 36.

^{5/} Regulations, §1.453-2(d). The Commissioner contends (Br. 10): "Indeed, the §1.453-2(d) rules are aptly suited to analysis of sales under Grant's coupon plan."

^{6/} Commissioner's Br. 33. The Commissioner (Br. 12, 34) refers to this mode of proof as a "sale-by-sale analysis."

^{7/} Commissioner's Br. 22, 37, 38.

Finally, contends the Commissioner, since the ¶2(d) proof rules require maintenance by the retailer of identifiable records (individual accounts) of customer coupon redemptions,^{8/} records of a type Grant did not maintain, the Trustee inevitably must fail.

In his brief to this Court, the Trustee did not focus mode of proof as an issue to be decided on this appeal. The Trustee viewed proof of qualifying installment sales under the Grant Plan as a matter properly to be determined by the Tax Court on remand.^{9/} The Trustee adheres to that view.

However, the Commissioner's brief selects mode of proof as the nub of the controversy. He has grounded his case on the specific contention that "an examination of the [proof] rules in ¶2(d)(2) and (3) demonstrates that those rules are suitable and appropriate for application to [¶2(b)(2)] plans in addition to those meeting the ¶2[d](1) definition of revolving plans."^{10/} Accordingly, the Trustee will devote the major part of this reply brief to the issue thus framed.

Contrary to the Commissioner's assertion, the Trustee will show that application of the ¶2(d) proof rules to the Grant Plan contravenes the statute. The Trustee then will show that the Internal Revenue Service historically and

^{8/} Commissioner's Br. 12, 31.

^{9/} Trustee's Br. 45, 70. The Commissioner has correctly noted that the Trustee's argument on this appeal "involves a factual inquiry as yet unconsidered by the Tax Court." Commissioner's Br. 23 n.11).

^{10/} Commissioner's Br. 28. See also his Br. 10 and 26 n.14, to similar effect.

consistently has permitted retailers to determine the qualifying percentage of installment sales under coupon plans by using methods other than ¶2(d) proof or sale-by-sale analysis.

I. THE COMMISSIONER GIVES WITH ONE HAND AND TAKES WITH THE OTHER: HE INVITES A HOLDING THAT THE ¶2(b)(2) REGULATION SIMULTANEOUSLY (1) AUTHORIZES INSTALLMENT TREATMENT FOR NON-TRADITIONAL PLAN SALES, BUT (2) DENIES TO THE RETAILER ANY MEANS OF PROOF.

A. Application of the ¶2(d) Proof Rules to the Grant Plan is Barred by Section 453(a)(2) of the Internal Revenue Code

¶2(d)(1) states, "[t]o the extent provided in this paragraph [2(d)], sales under a revolving credit plan will be treated as sales on the installment plan." ¶2(d)(1) then defines the term "revolving credit plan." Ancillary definitions are furnished by ¶2(d)(5) and (6). Revolving credit plan rules of proof are set forth in ¶2(d)(2) and (3), and illustrated in ¶2(d)(4) and (7).

Throughout ¶2(d), reference to "revolving credit plans" is exclusive.^{11/} The ¶2(d) regulation by its title and express terms is limited in application to "revolving credit plans" and applies to no others.

Nonetheless, the Commissioner now contends that the ¶2(d)(2) and (3) proof rules are "suitable and appropriate for application" to the Grant Plan, a non-traditional

^{11/} See also the second sentence of the "flush language" in ¶2(b)(2) (discussed at Trustee's Br. 25), and Rev. Proc. 64-4, 1964-1 (Part 1) Cum. Bull. 644, which prescribes sampling procedure guidelines for complying with the ¶2(d) proof rules. Sec. 4.03 of Rev. Proc. 64-4 is explicit: "The population from which the sample is to be selected is all accounts under a revolving credit plan as defined in section 1.453-2(d)(1) of the regulations." [Emphasis supplied].

installment plan that is not a revolving credit plan.^{12/}

The Commissioner is wrong. The revolving credit plan proof rules are neither "suitable" nor "appropriate" nor, indeed, permissible for application to the Grant Plan. While section 453(e) of the Code mandates application of these detailed, special proof rules to revolving credit plans, section 453(a)(2) forbids their application to a coupon book installment plan.

1. The Governing Code Provisions

Section 453(a)(2) of the Code provides:

Total Contract Price. -- For purposes of paragraph (1) [the dealer's election to report sales on the installment method], the total contract price of all sales of personal property on the installment plan includes the amount of carrying charges or interest which is determined with respect to such sales and is added on the books of account of the seller to the established cash selling price of such property. This paragraph shall not apply with respect to sales of personal property under a revolving credit type plan....^{13/} [Emphasis supplied].

The correlative statutory provision,^{14/} section 453(e) of the Code, states in pertinent part:

Carrying Charges Not Included in Total Contract Price. -- If the carrying charges or interest with respect to sales of personal property, the income from which is returned under subsection (a)(1), is not included in the total contract price, payments received with respect to such sales shall be treated as applying first against such carrying charges or interest.

^{12/} Compare Rev. Rul. 74-442, 1974-2 Cum. Bull. 152, in which the Commissioner, referring to a coupon plan and to this Court's 1973 decision rendered in the first appeal in the case at bar, made no mention at all of ¶2(d) or of the revolving credit plan proof rules.

^{13/} Added to the Code by P.L. 88-539, §3(a), in 1964.

^{14/} Also added to the Code in 1964 by P.L. 88-539, §3(b).

Sections 453(a)(2) and (e) interact as follows:

-- 1. Revolving credit sales are excluded from section 453(a)(2). Therefore, revolving credit sale finance charges always fall under section 453(e).

-- 2. Non-revolving credit installment sales are first tested under section 453(a)(2). It treats related finance charge as part of the installment sale if the finance charge "is added on the books of account of the seller to the established cash sale price" of the property sold.^{15/}

-- 3. In a non-revolving credit sale, if but only if finance charge is not recorded on the seller's books incident to the sale, section 453(a)(2) is rendered inapplicable. In that single case, the finance charge attributable to a non-revolving credit sale falls under section 453(e).

When Congress enacted sections 453(a)(2) and (e) in 1964, undoubtedly it had in mind and intended to distinguish between the two types of installment sales then familiar to it: traditional sales on the one hand, revolving credit sales on the other. In a traditional installment sale the total finance charge can be computed at the time of sale and booked by the retailer as part of the total contract price of the item sold. See Rev. Rul. 64-126, 1964-1 (Part 1) Cum. Bull. 170. Revolving credit plan sales are not susceptible to this treatment.

^{15/} The pertinent Committee Report, S.Rep. No. 1242, 88th Cong., 2d Sess. 4 (1964), 1964-2 Cum. Bull. 698, explains: "In specifying that the carrying charges, or interest, must be added to the established cash selling price to the books of account of the seller ... at least on a monthly basis.... [i]t is important to note that it is not required that the recording be on an individual customer basis."

In a revolving credit plan, the customer's account is "open" and finance charge is a function of an account balance which will vary upward or downward in response to subsequent purchases and payments by the customer. The total finance charge attributable to a specific revolving credit plan sale is not determinable at the time of that sale and therefore cannot be booked as part of the total contract price of the item sold. Sections 453(a)(2) and (e) correctly respond to commercial reality.^{16/}

Congress used the term "revolving credit type plan" in section 453(a)(2) in light of the open account plans with which it was familiar and the issue of finance charges which it correctly comprehended. Congress did not have in its 1964 focus the Grant coupon book installment plan, a non-traditional installment plan that is not a revolving credit plan. But under the statutory line Congress drew in 1964, which treats differently revolving credit plan finance charges and all other installment plan finance charges, the Grant Plan plainly and properly falls in the non-revolving credit plan category. As the Trustee demonstrates

^{16/} See generally S.Rep. No. 1242, supra n.15.

below,^{17/} under a coupon plan, and unlike a revolving credit plan, the finance charge can be determined at the time of sale and booked as an addition to the established cash selling price of the property.^{18/}

2. Treatment of Finance Charges Under the ¶2(d) Proof Rules

The revolving credit plan proof rules, in ¶2(d)(6), follow the mandate of Code section 453(e):

For purposes of this paragraph [2(d)]

-- (i) the term "sales" ... does not include finance or service charges.

* * *

-- (v) ... [F]or purposes of determining which charges remain in the balance of an account at the end of the last billing-month ending in a taxable year which began after December 31, 1963, payments received during such year shall be applied first against any finance or service charges which were outstanding at the time such payment was received.

These instructions are an integral part of the ¶2(d) proof rules. See ¶2(d)(4) Example (3). Because the ¶2(d) proof rules incorporate these finance charge instructions, they cannot be applied to cases described in Code section 453(a)(2). That is, the ¶2(d) proof rules cannot be applied to non-revolving credit plan sales when finance charges are recorded on the retailer's books incident to the sales.

^{17/} See the analysis in Appendix A to this reply brief.

^{18/} Recording on the retailer's books can be at month end (rather than at the time of each sale) and need not be on an individual customer basis. See page 6 n.15 supra.

The reason is simple. Applied to a ¶2(b)(2) coupon plan, the ¶2(d) proof rules would require that the retailer maintain a memorandum account for each customer, to which account sales (coupon redemptions) and finance charges must be separately recorded each month. But, pursuant to the governing directive of section 453(a)(2), recording the finance charge incident to the sale requires that the finance charge then be treated, not as a separate charge, but as part of the installment sale itself. This treatment -- the treatment of finance charge as part of the sale -- is impossible under the ¶2(d) proof rules. See ¶2(d)(6)(i).

The ¶2(d) proof rules cannot be applied to ¶2(b)(2) coupon plan sales for, if applied to coupon plan sales, the ¶2(d) rules inevitably yield a wrong answer. They yield an answer that contravenes governing section 453(a)(2). Confirmation is furnished by the detailed coupon plan account analysis set out in Appendix A to this reply brief.

B. Sale-By-Sale Analysis is not an Available Method of Proof

The Commissioner suggests (Br. 33) that a retail dealer "may literally satisfy the terms of ¶2(b)(2) by establishing as to each sale"^{19/} that (1) the plan by its terms and conditions contemplates such sale will be paid for in two or more payments, and (2) the sale is in fact paid for in two or more payments. The Commissioner then candidly admits (Br. 13, 37) he has proposed a mode of proof that could not conceivably be used by Grant or by any other volume retailer.

The Commissioner's sale-by-sale analysis may

^{19/} Emphasis supplied.

be open to question ^{20/} but his final conclusion -- that sale-by-sale analysis is impossible -- is not. Proof by individual examination of each sale in each customer account is no mode of proof at all.

C. The Resultant Construct

We are left with the Commissioner's extraordinary notion that in promulgating the ¶2(b)(2) regulation, the Treasury Department authorized coupon plans and other non-traditional/non-revolving credit retail installment plans but permitted the retailer no means of proving the correct percentage of qualifying installment sales: Sale-by-sale analysis concededly is impossible; the revolving credit plan proof rules produce a result contrary to the statute.

The Commissioner has presented us Catch-22.

^{20/} The Commissioner's reference to "each sale" is doubtful. It assumes that ¶2(b)(2) forbids aggregation of "small sales" made to a customer in a given month. No justification for that assumption appears in ¶2(b)(2). Nor is justification furnished by the Commissioner in his brief. The term "each sale" does not appear in ¶2(b)(2). It does, however, appear in ¶2(b)(1) under which a showing that two or more payments are contemplated is sufficient; ¶2(b)(1) does not require proof that "in fact" a sale is paid for in two or more payments.

Indeed, if the Commissioner is correct that ¶2(b)(2) requires "sale by sale analysis" of each coupon plan sale (see his Br. 31 n.20), he is plainly wrong in contending that the ¶2(d) proof rules alternatively may be employed. ¶2(d)(3)(i) and (ii) contain a "small sale rule." Under it all sales in any month are aggregated and, in effect, treated as one sale. Thus, if monthly payments are \$10 and sales in a given month are 3 items costing \$5 each, the sales are qualifying installment sales under ¶2(d) (because treated as one \$15 sale) but each of them is not a qualifying installment sale analyzed "sale by sale" (because \$5 is less than the next month's payment of \$10). It is impossible to conclude that the ¶2(b)(2) regulations contemplate two alternate proof rules that yield completely different results, unless one were merely a "minimum allowable percentage" qualification rule. See also Rev. Proc. 64-4, §4.021, 1964-1 (Part 1) Cum. Bull. 644, requiring for ¶2(d) proof statistical accuracy within a variation of not more than 2%.

II. THIS CASE SHOULD BE REMANDED TO THE TAX COURT TO ENABLE THE TRUSTEE TO DEMONSTRATE THE PERCENTAGE OF PLAN SALES QUALIFYING FOR INSTALLMENT TREATMENT.

The Commissioner contends that even if it is conceded the Grant Plan was not a revolving credit plan, remand to the Tax Court is not warranted. In the Commissioner's view, proof of qualifying installment sales can only derive from examination of identifiable records (individual accounts) of customer coupon redemptions. Since Grant did not maintain records of this type, the Commissioner concludes there is no means by which Grant may prove anything.

Grant did not maintain individual account coupon redemption records because there was no business reason for Grant to do so. The cost of maintaining voluminous records of this type would have been heavy. Since required payments by customers were unrelated to the time or amount of coupon redemptions, the business use of the records would have been nil.

The Commissioner's assertion that individual customer coupon redemption records are the sine qua non of proper proof derived from his contention that proof must be made pursuant to the revolving credit plan proof rules. These rules require analysis of randomly selected individual customer accounts. Those accounts are maintained by the revolving credit plan retailer for essential business reasons: from the account the retailer determines the amount and duration of monthly billings to the customer. Not so in coupon plans.

The Commissioner's assertion that individual customer coupon redemption records are the only basis upon which proof of qualifying ¶2(b)(2) installment sales may be premised is untenable. It is belied by longstanding contrary practice of the Internal Revenue Service.

A. The Internal Revenue Service Long and Consistently has Accepted as Valid a Percentage of Qualifying Coupon Plan Installment Sales Not Derived From Individual Customer Coupon Redemption Records

Many large volume retail concerns, in addition to Grant, have maintained coupon book installment plans. According to the best information the Trustee has been able to obtain from industry and accounting firm sources, at least during the ten years beginning 1963 and quite likely to the present day, none^{21/} of these retailers maintained individual customer account coupon redemption records.

If the Commissioner were correct in his central contention that the dealer installment sale regulations forbid proof by any method other than "sale-by-sale" or the ¶2(d) proof rules, a vast number of coupon plan retailers should have been denied claimed installment treatment by the Internal Revenue Service. This has not occurred. The only reported case of disallowance is the case at bar.

^{21/} On December 9, 1976, when Trustee's counsel wrote the letter referred to in n.22 (page 14 of this reply brief), a copy of which is annexed as Appendix B, available information suggested that one of Grant's retail competitors might have maintained individual customer coupon redemption records. Subsequently, it was learned that this was not the case.

Information obtained from industry and accounting firm sources indicates that no revenue agent auditing taxable years prior to 1974, other than the agent who audited Grant, disallowed coupon plan installment reporting because the retailer failed to maintain individual account redemption records.

To the contrary, for coupon plan retailers electing the installment method, according to the best information the Trustee has been able to obtain, at least through 1973 the audit practice of the Internal Revenue Service has been as follows. (1) In earlier years revenue agents routinely awarded 100% installment reporting qualification to coupon plan sales. (2) More recently, those auditing agents who do not continue to award 100% automatic qualification accept proof by the following method: The retailer determines the qualifying installment sale percentage for its revolving credit plan, applying the ¶2(d) proof rules to a proper sampling of the revolving credit plan accounts; the percentage thus derived is then applied to the coupon plan sales also. In no case, it appears, does the auditing agent require either "sale-by-sale" or ¶2(d) proof rules analysis of the coupon plan sales themselves.

If this information is accurate, the absence of any other reported case denying installment reporting by a coupon plan retailer is entirely explicable.

The Trustee is not positioned to obtain further information on this matter. But the government either has the

information already available or, because we are dealing with the administrative construction placed on the regulations by the Internal Revenue Service, the information can be obtained. As to the existence of disputes, the Internal Revenue Service easily can run a RIRA search.^{22/}

1. The Gimbel Brothers Case

Although there is no reported case, other than the case at bar, reflecting denial of installment treatment to a coupon plan retailer, there is a recent decision in which installment qualification of coupon plan sales is confirmed. Gimbel Brothers, Inc. v. United States, 535 F.2d 14 (Ct. Cl. 1976). Because the dispute in Gimbel focused on a different issue, all of the pertinent facts regarding that retailer's coupon plans are not recited in the court's opinion. They are, however, in the record on appeal which we have reviewed.

Gimbel maintained three coupon plans during the 15 taxable years January 31, 1952 through January 31, 1966, the years in issue in that case. In all pertinent respects the Gimbel coupon plans were similar to the Grant Plan, which Grant maintained during and subsequent to the same 15 years. During the years in issue Gimbel also maintained various traditional installment plans and various standard

^{22/} On December 9, 1976, after reviewing the government's brief (received December 3), counsel to the Trustee wrote to government counsel for the purpose inter alia of inviting the government to obtain further information from the Internal Revenue Service in time for the oral argument of this appeal. A copy of the December 9, 1976 letter sent by the Trustee's counsel is annexed to this reply brief as Attachment B.

revolving credit plans (in every year during the same period Grant maintained a traditional installment plan and a standard revolving credit plan).

In every year, Gimbel reported 100% installment qualification of its coupon plan sales. This reporting was accepted as proper by the Internal Revenue Service and, indeed, in the litigated case the government on February 5, 1974, stipulated that Gimbel had properly reported on the installment method income from all sales made under the coupon plans during the 15 years 1952-1966. In stipulating to 100% installment qualification of Gimbel's coupon plan sales, the government did not obtain from Gimbel customer coupon redemption records or any other identifiable customer records.

In its opinion the Court of Claims stated, 535 F.2d 17-18, the "parties agree that plaintiff's sales on its ... coupon accounts were sales on the revolving credit plan." Because of the nature of the dispute in the Court of Claims case, it was to Gimbel's advantage to enter into this stipulation. Certainly the government gave no thought to its conjunctive stipulation that (1) the Gimbel coupon plans were revolving credit plans, and (2) Gimbel had properly reported 100% installment qualification of sales under the coupon plans. Had the government given thought to its stipulation, it would have realized that under the revolving credit plan proof rules it is impossible

to reach a 100% qualification conclusion.^{23/}

Gimbel is the only reported case we have found, other than the case at bar, which makes reference to installment reporting of coupon plan sales. It involved 15 consecutive years including the years in issue in this proceeding. It furnishes concrete support for the information the Trustee has obtained from industry and accounting firm sources: Historically and consistently, the Internal Revenue Service at least through 1973 did not require proof of installment sale qualification based on individual customer coupon redemptions or any other individually identifiable customer account records.^{24/}

^{23/} The finance charge earned in the last month of the dealer's taxable year is always part of the customer's revolving credit plan account balance at year end. Under ¶2(d)(6)(i) and as required by Code section 453(e), that finance charge is not part of sales and thus this portion of the account balance can never constitute a qualifying installment sale receivable. See ¶2(d)(4) Example (3). Note, however, that a 100% qualification conclusion can be reached for ¶2(b)(2) plan sales, although not under the ¶2(d) proof rules. See part I of this reply brief and Appendix A.

After the publication of Rev. Rul. 74-442, 1974-2 Cum. Bull. 152 (discussed in n.24, below), the government sought to be relieved of the burden of its stipulation in Gimbel. The Court of Claims denied the government's motion.

^{24/} The Trustee has not been informed that the Internal Revenue Service changed its consistent administrative practice subsequent to 1973. The Trustee merely lacks information. For many retailers years subsequent to 1973 are still in audit. Additionally, in 1974 the Internal Revenue Service published Rev. Rul. 74-442, 1974-2 Cum. Bull. 152 which, for the first time, publicly announced the Service would require proof of installment sale qualification based on individual customer coupon redemption records.

2. Relevance to the Case at Bar

It is hardly appropriate for the Commissioner to assert that the ¶2(b)(2) regulation forbids any method of proof that is not based upon individual customer account redemption records, when the Internal Revenue Service all along has accepted proof by other means. A long history of recognition by the Service of other modes of coupon plan proof bears directly on the issue focused by the Commissioner on this appeal.

(a) Alternate Proof is Permissible

The Trustee seeks the opportunity to demonstrate to the Tax Court on remand that the percentage of Grant plan sales qualifying for installment treatment can be derived using data regularly maintained by Grant (Trustee's Br. 49-50).^{24a/} The Commissioner argues (Br. 32-36) that the regulation forbids any mode of proof that is not based upon records of coupon redemptions individually identifiable by customer.^{25/}

"Persuasive evidence" of the correct interpretation of the ¶2(b)(2) regulation is "the interpretation put upon the [regulation] by the agency charged with the

^{24a/} On remand the Trustee also will contend that coupon redemption sales made during the first eleven months of each taxable year qualified as sales on the installment plan, and thus established a basis for determining annually the minimum percentage of qualifying installment sales. See also this Court's reference to "the last month of the tax year" in its opinion rendered in the first appeal (R. 50).

^{25/} The Commissioner also argues (Br. 33) that ¶2(c)(1) of the regulations is "simply a record retention requirement." This is incorrect. Regulation, §1.453-1(f), aptly entitled "records," performs that function.

responsibility of administering the revenue laws."^{26/} Consistent longstanding administrative recognition of modes of proof not based upon individual customer redemption records confirms that maintenance of such records is not an inevitable prerequisite to obtaining installment treatment.

(b) Qualification Established by
Consistent Administrative Interpretation

The tax law comprehends proof of facts by statistical methods, estimation, survey and other reasonable means.^{27/} An underlying notion is that when exact proof is

^{26/} Hanover Bank v. Commissioner, 369 U.S. 672, 686 (1962). The Supreme Court was there referring to administrative construction embodied in unpublished private rulings. The rulings procedure is instructive. The descending Table of Organization is Office of the Commissioner, Office of the Assistant Commissioner (Technical), Division, Branch, Ruling Section and Ruling Group. A private letter ruling is prepared by an Internal Revenue Service employee assigned to a Ruling Group. It is reviewed by the Ruling Group chief and, normally with less intensity, at the Section level. Ordinarily a private letter ruling is not reviewed or approved at a level higher than Branch. Thus, the administrative construction to which the Supreme Court had reference was administrative construction at the working level of the Service.

^{27/} The ¶2(d) proof rules provide an example. Under this statistical method of proving the percentage of qualifying installment sales under a revolving credit plan, variations of up to 2% are contemplated and permissible. Rev. Proc. 64-4, §4.021, 1964-1 (Part 1) Cum. Bull. 644. Other provisions of the income tax regulations which permit the taxpayer to formulate and use proof methods employing sampling, probability or statistical techniques include §1.47-1(e)(2)(i) (investment tax credit) and §1.472-8(e)(1) (LIFO inventory computations). Judicial authority includes Cohan v. Commissioner, 39 F.2d 540 (2d Cir. 1930); Pittsburgh Press Club v. United States, 536 F.2d 572 (3d Cir. 1976); Jerrell Monroe Sparks, 19 T.C.M. 807 (1960); Prosperity Company, Inc. 17 T.C. 171 (1951); Emily Marx, 13 T.C. 1099 (1949).

impossible or impractical but it is fair to conclude the taxpayer's claim has merit, the Internal Revenue Service or a court may honor the claim to the degree not inconsistent with protection of the revenue.

No one seriously doubts the vast majority of coupons is redeemed in two payment sales. It is evident that for any retailer, the percentage of two payment sales to coupon plan customers will exceed the percentage of qualifying (two payment) sales to that retailer's revolving credit plan customers.^{28/} As a matter of administrative practice, convenience and fairness, the Internal Revenue Service properly may (1) view the quantum of non-qualifying coupon plan sales as de minimus^{29/} and award 100% qualification to coupon sales or

^{28/} Two factors support this conclusion. First, prompt full redemption of his or her coupons does not accelerate or increase the customer's payment obligation; purchases by a revolving credit plan customer increase the total payment obligation and also increase monthly payment if under the plan payment is required in a fixed percentage of the account balance. Thus, the budget considerations that may inhibit revolving credit plan purchases have no application to coupon plan customers. Second, because of the differential treatment accorded finance charges in Code sections 453(a)(2) and (e), see Appendix A to this reply brief, on any set of comparable facts the qualifying percentage of installment sales will be higher under a coupon plan than under a revolving credit plan.

^{29/} See, e.g., Rev. Rul. 69-334, 1969-1 Cum. Bull. 98, in which the Internal Revenue Service allowed current loss on a corporate liquidation by applying a de minimus concept. Had that concept not been applied, the loss would not have been allowed until a later taxable year.

(2) accept as the minimum qualifying percentage of coupon sales the retailer's separately computed qualifying percentage of its revolving credit plan sales. According to the information the Trustee has obtained, the Service through consistent longstanding administrative interpretation has construed ¶2(b)(2) to permit qualification under these standards.

(c) Discrimination

"The Commissioner cannot tax one and not tax another without some rational basis for the difference." United States v. Kaiser, 363 U.S. 299, 308 (1960) (Frankfurter, J., concurring). The Commissioner cannot tax Grant on sales under its coupon plan and, in the very same years, not tax Grant's competitors when there is no rational basis for the difference. Iowa-Des Moines National Bank v. Bennett, 284 U.S. 239 (1931) (Brandeis, J.) (revenue auditor's imposing correctly determined tax liability on Bank when its competitors were incorrectly assessed lower tax held to discriminate impermissibly against Bank).^{30/}

^{30/} See Sioux City Bridge Company v. Dakota County, 260 U.S. 441 (1923); Hamilton Nat. Bank v. District of Columbia, 156 F.2d 843 (D.C. Cir. 1946). See also International Business Machines Corporation v. United States, 343 F.2d 914 (Ct. Cl. 1965), cert. denied, 382 U.S. 1028 (1966). Cf. Sirbo Holdings, Inc. v. Commissioner, 509 F.2d 1220 (2d Cir. 1975), noting the presence in IBM of competing considerations of proper tax administration; such factors are not present in the case at bar which involves consistently different and better treatment of Grant's competitors over an extended period of years.

B. Remand to the Tax Court is Appropriate and Necessary

Relevant to deciding the case at bar is the way in which the Internal Revenue Service, in its administrative interpretation and application of the ¶2(b)(2) regulation, treated Grant's competitors during the taxable years 1964 and 1965 and during the subsequent taxable years for which the Commissioner has filed an \$84 million proof of claim in the Grant bankruptcy proceeding. If Grant's competitors, maintaining no individual coupon redemption records, consistently were accorded installment treatment, it may be appropriate to inquire whether the consistent administrative interpretation was the product of coincidence or reflected formulated policy.

We have asked the Commissioner's counsel to obtain for the Court such data as may be in the possession of the Internal Revenue Service and currently available.^{31/}

^{31/} See Appendix B. In comparable circumstances Courts of Appeals have requested and secured from the Department of Justice information in the possession of the Internal Revenue Service. See First National Bank of Birmingham v. United States, 358 F.2d 625 (5th Cir. 1966) (explanation in concurring opinion); United States v. Cocke, 399 F.2d 433 (5th Cir. 1968); Ross v. Odom, 401 F.2d 464 (5th Cir. 1968). It is understood that during the oral argument before this Court in Ruperto Roberto v. United States, 518 F.2d 1109 (2d Cir. 1975), taxpayer's counsel alleged that the Commissioner was applying the tax in issue against his client but was not enforcing the tax statute against other similarly situated taxpayers. The attorney then offered an example of a purportedly similarly situated taxpayer against whom the tax had not been enforced. The Court (the bench was Judges Friendly, Mansfield and Bartels) asked government counsel if the taxpayer's attorney was correct. Government counsel stated lack of knowledge and offered to inform the Court of the facts by supplemental papers. It is understood that the supplemental information confirmed the taxpayer's attorney to have been incorrect. The case was decided for the government.

We anticipate that such data, if furnished, will be consistent with the Trustee's understanding of the tax treatment long accorded Grant's competitors. But we do not believe all relevant information will be furnished. To obtain it, remand to the Tax Court for fuller disclosure and appropriate discovery is required.

The Trustee does not contemplate burdensome review of the audit experience of Grant's literally thousands of retail competitors. A reasonable sampling of retailer coupon plan experience during taxable years commencing with 1964 can be undertaken by the Service, with the Trustee's assistance in identifying Grant's coupon plan competitors if the Tax Court so instructs. Consequent upon the outcome of that review, the Trustee should be permitted, through discovery, to obtain full disclosure of the administrative mechanism.

III. "LAW OF THE CASE" IS NOT IN POINT

This Court's clear authority to consider the proper analysis of the controlling tax regulation is not in dispute (Commissioner's Br. 21). But the Commissioner wholly misconceives the Trustee's position as to the scope of the prior decision and flagrantly understates the level of injustice that would result were the prior decision allowed to stand.

A. The Trustee's Position

The Commissioner announces (Br. 23 n.11):

We believe the Court's determinations on the prior appeal necessarily include a rejection of the trustee's argument, and, indeed, the trustee does not appear seriously to suggest otherwise.

The Commissioner is incorrect. The Trustee strongly contends that the issues raised and analysis proffered by the Trustee on this second appeal -- and, indeed, the responses offered by the Commissioner in his brief -- were not presented to or conceived by the Court when Grant argued the first appeal.

In the first appeal the Court's attention was not called to the 1962 proposed regulations. It was not until the filing of his brief on this second appeal that the Commissioner conceded, whether "for argument" or otherwise: (1) the regulations contemplate a non-traditional installment plan that is not a revolving credit plan; (2) the Grant plan was one such ¶2(b)(2) plan. It was not until his brief on this appeal that the Commissioner contended proof of qualifying installment sales under a ¶2(b)(2) plan must be made either through "sale-by-sale analysis" or pursuant to the ¶2(d) revolving credit plan proof rules, rules which by their terms are not applicable to plans other than ¶2(d)(1)-defined revolving credit plans. And, most certainly, in the first appeal this Court's attention was not called to Code sections 453(a)(2) and (e), to the Gimbel Brothers case (decided after the first appeal), or to the Service's longstanding and consistent administrative interpretation of ¶2(b)(2) as that regulation applies to coupon plans.

It is patent that the Trustee's arguments on this appeal, and the Commissioner's responding arguments as well, raise issues not considered in either Tax Court

proceeding or in the first appeal.^{32/} The Commissioner concedes as much at page 23 n.11 of his brief. Accordingly, "law of the case" has no application in this proceeding. United States v. Furey, 514 F.2d 1098, 1102 (2d Cir. 1975) ("Our previous decision constitutes the law of the case only as to those issues specifically presented to and decided by the Court on [prior] appeal."); Hartford Life Ins. Co. v. Blincoe, 255 U.S. 129, 136 (1921) ("Certainly, omissions do not constitute a part of a decision and become the law of the case...."); additional authority cited in Trustee's original brief, pages 66-69.^{33/}

B. The Level of Injustice

The Commissioner concedes (Br. 7 n.8) that the issue before this Court is a principal item underlying the Commissioner's \$84 million proof of claim in the Grant bankruptcy. This vast sum is additional to the \$9,800,000 assessed deficiency the Commissioner already has collected for taxable years 1964 and 1965. Astonishingly, the

^{32/} Cf. International Flavors & Fragrances, Inc. v. Commissioner, 524 F.2d 357 (2d Cir. 1975) (Remand required where Commissioner winner below, on appeal relied on theory different from basis of Tax Court decision).

^{33/} The Commissioner's assertion (Br. 23 n.11) that the Trustee's argument is untimely raised is without merit. The single authority cited by the Commissioner, Dall v. Commissioner, 228 F.2d 526 (2d Cir. 1955) is not controlling. Compare the later decisions in Lauinger (in which this Court noted but did not follow Dall), Triple R Welding, North American Leisure and Green v. Brown, cited on pages 55-59 of the Trustee's original brief. Dall stands for nothing more than that the appellate court's authority to hear newly raised argument includes discretion not to hear such argument absent appropriate justification. In all events, the Commissioner cannot allege that the Trustee has been dilatory. The Trustee was not party to this case until Grant became bankrupt, an event that occurred subsequent to the filing of the notice of this second appeal.

Commissioner alleges (Br. 23 n.11) that this gigantic liability, a liability principally attributable to the bankruptcy of Grant (see Trustee's Br. 8-10), is not an "exceptional circumstance." The Commissioner then concludes (Br. 39 n.26), "Although we do not suggest that no injustice would result were the prior decision seriously incorrect, it should be noted that the trustee exaggerates the effect of Grant's bankruptcy on the tax deficiencies arising from the coupon plan issue."

The Commissioner's position is untenable. One of the largest commercial bankruptcies in the nation's history is an exceptional circumstance, as is the resultant asserted tax liability in this \$93 million income tax case. That it is solely the bankruptcy of Grant that converted this dispute into a \$93 million income tax case is demonstrable by simple arithmetic. See the Trustee's original brief at page 9 n.5. The lone authority cited by the Commissioner (Br. 39 n.26), a law review article written in 1968, does not support the Commissioner's contention. To the contrary, it specifically confirms the opposite conclusion when, as was true of the Grant Plan, the volume of coupon sales increased substantially over the years.

The extraordinary level of injustice inherent in an erroneous decision of this case is easily shown.^{34/}

^{34/} The facts set forth below are not contained in the record, since they occurred after the Notice of Appeal and, in part, after the filing of the Trustee's original brief. However, the facts are historic and, in any event, this Court may take judicial notice of them since they are reflected in judicial proceedings now pending before the United States District Court for the Southern District of New York (Bankruptcy No. 75 B 1735).

The Trustee inherited from Grant the staggering total of some \$426 million in uncollected accounts receivable.^{35/}

Failure of Grant plan customers to make required monthly payments for the coupons they had acquired and redeemed for merchandise accounted for a large part -- estimated at more than \$100 million -- of this total.

On November 15, 1976, at a hearing before Judge Galgay, the Trustee sold the entire block of \$426 million of uncollected receivables to an independent buyer. The purchase price was \$44 million plus a small contingent override.

The point is evident. The Commissioner is not assessing tax on deferred payments Grant later received. The Commissioner is assessing tax on phantom income, on payments Grant never received.

In its first opinion (R. 48) this Court noted, "Installment reporting was enacted as a relief provision to allow a merchant first to actually realize profits arising from deferred payment transactions before requiring that tax be paid on the gain." Surely that relief must encompass the case in which deferred payment is non-payment and profits are never realized.

Essentially, this is a dispute between nearly 15,000 suppliers and other individual and commercial creditors

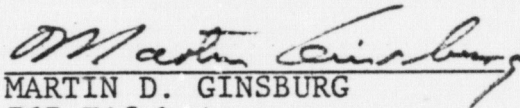
^{35/} Of this total, \$276 million was computer recorded and an estimated \$150 million was pre-computer.

of Grant, and the Commissioner of Internal Revenue. These suppliers and other creditors suffered real losses of many times \$93 million. The Commissioner seeks \$93 million of income tax on non-existent income. He seeks to prevail whether or not this Court concludes its prior decision was erroneous (Commissioner's Br. 23 n.11). The Commissioner has a strange perception of what constitutes injustice.

CONCLUSION

For the reasons stated, the decision of the Tax Court should be reversed and the case remanded.

Respectfully submitted,


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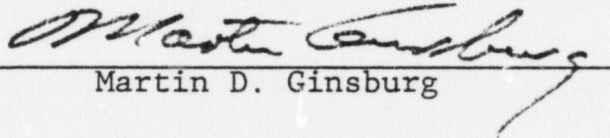
Of Counsel

December, 1976

CERTIFICATE OF SERVICE

I hereby certify that I have this 17th day of
December, 1976 served the foregoing Reply Brief for Appellant
on respondent-appellee by causing copies to be mailed to:

Joseph L. Liegl, Esq.
Tax Division
Department of Justice
Washington, D. C. 20530


Martin D. Ginsburg

APPENDIXES

Appendix A

Coupon Analysis

Appendix B

Letter Dated December 9, 1976
From Trustee's Counsel to
Government Counsel

Appendix C

Relevant Statute and Regulations

APPENDIX AI. Coupon Plan - Principles
of Account Presentation

It is assumed that Retailer is a dealer in personal property with a taxable year ending January 31. The terms of its coupon book installment plan are as follows:

For a book of coupons redeemable for \$100 total merchandise, customer must pay \$10 per month (beginning the following month) for eleven consecutive months, total cost \$110 (\$100 redemption value plus \$10 finance charges).

If a coupon plan customer does not redeem all coupons, he or she may return unused coupons to the Retailer and receive cash refund of the redemption value plus the allocable finance charge. Example: In January, 1964 customer acquires a \$100 book of coupons and pays \$110 over the next eleven months. Customer redeems for merchandise only \$60. In January, 1965 customer returns to Retailer the unused \$40 of coupons and is refunded \$44, the redemption value plus 40% of the total \$10 finance charge. Thus, Retailer records finance charge on its books as coupons are redeemed (the Retailer records \$1 of finance charge for each \$10 of coupons redeemed since total finance charge is 10% of total coupon redemption value).

For each coupon plan customer, Retailer establishes and maintains an individual memorandum account to which is

posted coupon redemptions, finance charges and customer payments.

II. Coupon Sales Illustration

On October 2 (of Retailer's taxable year-1) customer A acquires from Retailer a book of coupons redeemable for \$100 total merchandise. Customer A agrees to pay \$10 per month on the second day of each of the next eleven calendar months, first payment to be made November 2. Total cost to customer A is \$110. During the five months October, year-1 through February, year-2, the following activity is recorded in the customer A memorandum account maintained by Retailer (the illustration assumes there are no returns or allowances credited to the account during the five month period shown).

	<u>Aggregate Sales (Coupon Redemptions) During Month</u>	<u>Customer Payment During Month</u>
October	\$ 25.00	0
November	8.00	\$10
December	9.50	10
January	17.00	10
February	20.00	10

III. Qualifying Installment Sales Determined by Applying the Revolving Credit Plan Proof Rules*

In accordance with the mandate of section 453(e) of the Internal Revenue Code, the revolving credit plan proof rules require the following treatment of finance charges:

* Also summarized in attached Chart A, p. 9a.

¶2(d)(6)(i) - the term "sales" ... does not include finance or service charges.*

¶2(d)(6)(v) - ... [F]or purposes of determining which charges remain in the balance of an account at the end of the last billing-month ending in a taxable year which began after December 31, 1963, payments received during such year shall be applied first against any finance or service charges which were outstanding at the time such payment was received.*

Because the quoted portions of the revolving credit plan proof rules require separate treatment of finance charges, the memorandum account maintained for customer A will reflect the following:

	<u>Aggregate Sales (Coupon Redemptions) In Month</u>	<u>Finance Charges Recorded In Month</u>	<u>Payments</u>	<u>Account Balance At Month End</u>
October	\$ 25.00	\$ 2.50	0	\$ 27.50
November	8.00	.80	\$10	26.30
December	9.50	.95	10	26.75
January	17.00	1.70	10	35.45
February	20.00	2.00	10	47.45

The revolving credit plan proof rules require determination of the composition of the year-end (January 31) account balance of \$35.45 -- the portion of the balance qualifying as sales on the installment plan vs. the portion of the balance that does not so qualify. In making that determination, the revolving credit plan proof rules require that each customer payment received during the taxable year first be allocated to any outstanding

* The application of this treatment of finance charges under the revolving credit plan proof rules is illustrated in ¶2(d)(4) Example (3) of the regulations.

balance of finance charges. The remainder of the customer payments received during the taxable year then is allocated to sales on a first-in/first-out basis.

<u>Customer Payment</u>	<u>Allocated to Finance Charges</u>	<u>Allocated to Sales</u>
November - \$10	October - \$2.50	October - \$7.50
December - 10	November - .80	October - 9.20
January - 10	December - .95	October - 8.30
		November - .75

As the chart demonstrates, payments received from customer A during the taxable year (ending January 31), allocated as required by the revolving credit plan proof rules, have offset in full October, November and December finance charges, have offset in full October sales of \$25, and have offset \$0.75 of November sales (since November sales were \$8, the remaining balance of November sales is \$7.25). Therefore, the year-end (January 31) balance of \$35.45 in the customer A memorandum account is made up of the following charges:

Balance of November sales	\$ 7.25
December sales	9.50
January sales	17.00
January finance charges	<u>1.70</u>
Year-end account balance	<u>\$35.45</u>

Qualification Analysis of
Year-End Account Balance

1. The balance of November sales (\$7.25) does not qualify as an installment sale since the total

November sales charge (\$8) was less than payment (\$10) required in December, the following month.

2. December sales (\$9.50) does not qualify as an installment sale since the total December sales charge (\$9.50) was less than payment (\$10) required in January, the following month.

3. January sales (\$17) does qualify as an installment sale since the total January sales charge (\$17) exceeded payment (\$10) required in February, the following month, and the actual payment in February (\$10) is less than the balance in the account (\$35.45) at the end of January.

4. January finance charge (\$1.70) does not qualify as an installment sale receivable because, under the revolving credit plan proof rules, finance charge is not part of "sales." Accordingly:

	<u>Qualifying Installment Sales</u>	<u>Non-Qualifying Charges</u>
Balance of November Sales	-	\$ 7.25
December Sales	-	9.50
January Sales	\$17.00	-
January Finance Charges	<u>-</u>	<u>1.70</u>
	\$17.00	\$18.45

Thus, under the revolving credit plan proof rules, of the \$35.45 balance in the customer A memorandum account at January 31 year-end, \$17 (47.955%) is treated as sales

on the installment plan.*

IV. Qualifying Installment Sales
Determined as Required by
Code Section 453(a)(2)**

Under section 453(a)(2) of the Code, finance charge is treated as part of the sale. Under the installment plan here analyzed, with respect to each coupon redemption sale finance charge is equal to, and is booked by the Retailer as, 10% of the cash selling price of the item sold (i.e., cash selling price \$25 plus finance charge \$2.50 equals section 453(a)(2) total contract price of \$27.50). Therefore, the memorandum account maintained for customer A will reflect the following:

	<u>Aggregate Sales (Coupon Redemp- tions Plus Finance Charge) in Month</u>	<u>Payments</u>	<u>Account Balance at Month End</u>
October	\$ 27.50	0	\$ 27.50
November	8.80	\$10	26.30
December	10.45	10	26.75
January	18.70	10	35.45
February	22.00	10	47.45

Required is a determination of the composition of the year-end (January 31) account balance of \$35.45 -- the portion of the balance qualifying as sales on the installment plan vs. the portion of the balance that does not so qualify. In making this determination, no allocation as between sales and finance charges is required or

* If the Retailer's taxable year began before January 1, 1964, on the facts of the example the qualifying amount would be the same (\$17). See ¶2(d)(6)(v), ¶2(d)(4) Example (2).

** Also summarized in attached Chart B, p. 10a.

permitted since finance charges are treated as part of sales. Therefore, customer payments received during the taxable year are allocated to sales on a first-in/first-out basis.

<u>Customer Payment</u>	<u>Allocated to Sales</u>
November - \$10	October - \$10.00
December - 10	October - 10.00
January - 10	October - 7.50
	November - 2.50

As the chart demonstrates, payments received from customer A during the taxable year (ending January 31), allocated as required by Code section 453(a)(2), have offset in full October sales of \$27.50 and have offset \$2.50 of November sales (since November sales were \$8.80 inclusive of finance charges, the remaining balance of November sales is \$6.30). Therefore, the year-end (January 31) balance of \$35.45 in the customer A memorandum account is made up of the following charges:

Balance of November Sales	\$ 6.30
December Sales	10.45
January Sales	<u>18.70</u>
Year-End Account Balance	<u><u>\$35.45</u></u>

Qualification Analysis of
Year-End Account Balance

1. The balance of November sales (\$6.30) does not qualify as an installment sale since the total November sales charge (\$8.80) was less than payment (\$10) required in December, the following month.

2. December sales (\$10.45) does qualify as an installment sale since the total December sales charge (\$10.45) exceeded payment (\$10) required in January, the following month, and the actual payment in January (\$10) is less than the balance in the account (\$26.75) at the end of December.

3. January sales (\$18.70) does qualify as an installment sale since the total January sales charge (\$18.70) exceeded payment (\$10) required in February, the following month, and the actual payment in February (\$10) is less than the balance in the account (\$35.45) at the end of January. Accordingly:

	<u>Qualifying Installment Sales</u>	<u>Non-Qualifying Charges</u>
Balance of November Sales	-	\$ 6.30
December Sales	\$10.45	-
January Sales	<u>18.70</u>	<u>-</u>
	\$29.15	\$ 6.30

Thus, determined in accordance with the requirements of Code section 453(a)(2), of the \$35.45 balance in the customer A memorandum account at January 31 year-end, \$29.15 (82.228%) is treated as sales on the installment plan.*

* This determination reflects one of two alternate assumptions: Either (1) there was only one sale to customer A in each of December and January, or (2) ¶2(b)(2) allows a "small sales rule" equivalent to the rule set out in ¶2(d)(3)(i) of the revolving credit plan regulations. See the discussion of this latter point at page 10 n.20 of the Trustee's reply brief to which this Appendix A is annexed.

COMPUTATION PER 1.453-2(d)

9a

CHART A

Month	Sales (Coupon Redemptions)	Finance Charges (A)	Required Actual Payment	Month End Balance	Application of Payments		Composition of Year-End Balance
					Amount	From Month of	
October	25.00	2.50		27.50	(10.00) (9.20) (8.30)	November December January	-0-
November	8.00	.80	(10.00)	26.30	(0.75) (0.80)	January December	7.25 (B)
December	9.50	.95	(10.00)	26.75	(0.95)	January	9.50 (C)
January	17.00	1.70	(10.00)	35.45			17.00 (D) 1.70 (E) 35.45
February	20.00	2.00	(10.00)	47.45			

(A) Finance charge equal to 10% of coupons redeemed is recorded in month of redemption.

(B) Does not qualify as an installment sale because total November sales (\$8.00) are less than required monthly payment (\$10.00).

(C) Does not qualify as an installment sale because total December sales (\$9.50) are less than required monthly payment (\$10.00).

(D) Qualifies as an installment sale because total January sales (\$17.00) exceed the required monthly payment (\$10.00) and the February payment (\$10.00) is less than the January month-end balance (\$35.45).

(E) Does not qualify as an installment sale because finance charges are excluded from the definition of a sale under revolving credit plan regulations.

Accordingly, \$17.00 of the total January balance of \$35.45 qualifies as installment sales: 47.955%

COMPUTATION PER 453(a)(2)

Month	Coupon Redemptions	Finance Charges (A)	Total Sales	Required (Actual) Payment	Month-End Balance	Application of Payments		Composition of Year-End Balance
						Amount	From Month of	
October	25.00	2.50	7.50		27.50	(10.00) (10.00) (7.50)	November December January	-0-
November	8.00	.80	8.80	(10.00)	26.30	(2.50)	January	6.30 (B)
December	9.50	.95	10.45	(10.00)	26.75			10.45 (C)
January	17.00	1.70	18.70	(10.00)	35.45			18.70 (D) 35.45
February	20.00	2.00	22.00	(10.00)	47.45			

(A) Finance charge equal to 10% of coupons redeemed is recorded in month of redemption.

(B) Does not qualify as installment sale because total November sales (\$8.80) are less than the required monthly payment (\$10.00).

(C) Qualifies as an installment sale because total December sales (\$10.45) exceed the required monthly payment (\$10.00) and the January payment (\$10.00) is less than the December month-end balance (\$26.75).

(D) Qualifies as an installment sale because total January sales (\$18.70) exceed the required monthly payment (\$10.00) and the February payment (\$10.00) is less than the January month-end balance (\$35.45).

Accordingly, \$29.15 of the total January balance of \$35.45 qualifies as installment sales: 82.228%

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TELEX
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423144

December 9, 1976

Joseph L. Liegl, Esq.
Tax Division
Department of Justice
Washington, D.C. 20530

Re: Charles G. Rodman, as Trustee of the
Estate of W. T. Grant Company, Bankrupt
v. Commissioner of Internal Revenue
No. 75-4214 (CA 2)

Dear Mr. Liegl:

This letter is to confirm our telephone conversation of earlier today.

In light of certain positions taken by the government in its brief to the Court of Appeals, I anticipate that in his reply brief the Trustee will raise two issues the answers to which are known or available to the government and cannot be obtained by the Trustee or the Court other than from the government. I bring these issues to your early attention so that the Department of Justice will have sufficient time to obtain the information from other government sources (respectively the Treasury Department and the Internal Revenue Service) and be able to present the information to the Court of Appeals and the Trustee in advance of oral argument.

1. Changes in the Regulations

In its brief at page 25 n.13, the government states:

For example, we dispute the trustee's assertion that ¶2(b)(2) was added to the Regulations before promulgation in final form in 1963 simply to "fill the gap" between traditional installment plans and revolving credit plans in the Regulations proposed in 1962. We likewise disagree that this addition of ¶2(b)(2) was the only major revision made to the proposed Regulations (Br. 16.)

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The public record does not support these assertions, and indeed it suggests that they are quite inaccurate. Retailers were greatly concerned with the proof procedures in §1.453-2(d) of the proposed Regulations, and succeeded in persuading the Treasury to modify the so-called "small sale rule" of §1.453-2(d)(3)(i) very substantially....

In its brief the government states that it "dispute[s] the trustee's assertion" re "fill the gap " but does not state any grounds for a contrary position other than a reference to the "public record."*

¶2(b)(2) was added to the regulations in 1963. The Trustee asserts that the addition must have been for the purpose that ¶2(b)(2) solely serves: to "fill the gap." On brief the government denies this but articulates no contrary explanation.

But the one and only source of further information on this disputed issue is the government itself.

Specifically, we are informed, over many years including 1962 and 1963 it has been the procedure of the Treasury Department, when a tax regulation is promulgated in final form, to prepare an internal technical memorandum stating, for future guidance, the purpose of the changes made in and additions to the proposed form of regulation.

Since the government disputes the Trustee's "fill the gap" analysis and since the government, on brief, cites to nothing other than the silence of the "public record,"* we think

* The government's reference to the "public record" is surprising. The Treasury Department has informed us that there is no extant public record as to §1.453-2 of the Regulations, and the articles cited in the government's brief do not refer to any public record. If, contrary to the Treasury's information, there is a "public record" that you have reviewed, we too should like to review it.

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it incumbent upon the government to offer to the Court a copy of the Treasury's technical memorandum that explains the 1963 changes in and additions to the 1962 proposed section 453 regulations.

To enable the Trustee's counsel to present to the Court an informed oral argument with respect to the technical memorandum, we ask that a copy of it be supplied to us at least five days prior to argument.

2. Method of Proof

In its brief the government has conceded "for purposes of argument" a number of the Trustee's main contentions. As presented to the Court on this second appeal, a coupon book installment plan is a ¶2(b)(2) non-traditional installment plan that is not a revolving credit plan.

In the case of such a "¶2(b)(2) plan," it is the government's position that the retailer must make proof of qualifying installment sales either "sale by sale" -- which the government correctly points out is an impossible task for a volume retailer -- or by applying the ¶2(d)(2) & (3) revolving credit plan rules of proof (even though the ¶2(b)(2) plan is not a revolving credit plan). Those rules of proof require analysis of individual account redemptions and, the government avers, since Grant did not maintain records of individual account redemptions Grant inevitably must lose.

The heart of the government's case, therefore, is the allegation that the dealer installment sale regulations forbid a tender of proof by any method other than "sale by sale" or the ¶2(d) proof rules.

In his brief the Trustee had viewed matters of proof as the proper concern of the Tax Court on further remand. Because the government has focused proof as the dominant issue before the Court of Appeals, in his reply brief the Trustee also will focus on this issue.

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A great many retail concerns have maintained coupon book installment plans. As pointed out in the government's brief, no volume retailer can make proof of installment sale qualification "sale by sale." According to the best information we have been able to obtain from industry and accounting firm sources, at least during the ten years beginning 1963 and quite likely to the present day, few if any of these retailers maintained records of individual account redemptions.

If the government is correct in its central contention that the dealer installment sale regulations forbid proof by any method other than "sale by sale" or the ¶2(d) proof rules, it should follow that a vast number of coupon plan retailers have been denied claimed installment treatment by auditing revenue agents. As far as we can ascertain, however, this is not true. The only reported case of disallowance is Grant's case. Information obtained from industry and accounting firm sources indicates that no auditing revenue agent, other than Grant's agent, is known to have disallowed coupon plan installment reporting because the retailer failed to maintain individual account redemption data.

To the contrary, for coupon plan retailers electing the installment method, according to the best information we have been able to obtain, at least through 1973 the audit practice of the Internal Revenue Service has been as follows: (1) in earlier years revenue agents routinely awarded 100% installment reporting qualification to coupon plan sales. (2) More recently, those auditing agents who do not continue to award 100% automatic qualification utilize the following method of proof: the retailer determines the qualifying installment sale percentage for its separate standard-type revolving credit plan, applying the ¶2(d) proof rules to a proper sampling of the true revolving credit accounts; the percentage thus derived is then applied to the coupon plan sales also. In no case, it appears, does the auditing agent require either "sale by sale" or ¶2(d) proof rules analysis of coupon plan sales themselves.

If this information is accurate, the absence of any other reported case challenging installment reporting by a coupon plan retailer is entirely explicable.

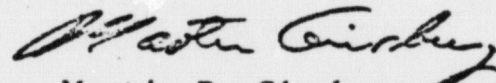
The relevance to the case at bar of this information is apparent. It is hardly appropriate for the government to assert that the regulations forbid any method of proof other than "sale by sale" or ¶2(d) proof if in fact the Internal Revenue Service all along has been accepting another method of proof and, indeed, a method that Grant (which like virtually every other coupon plan retailer also maintained a standard revolving credit plan) can satisfy.

The Trustee is not positioned to obtain further information on this matter. But the government either has the information already available or, because we are dealing with a question of Internal Revenue Service audit practice, can obtain it. With respect to the existence of disputes, the Internal Revenue Service easily can run a RIRA search.

The government has focused the proof issue as the main issue in the Court of Appeals. We believe that a proper and just resolution of the issue requires that the government furnish to the Court and the Trustee all pertinent information. We ask that such information be supplied to us at least five days prior to the oral argument.

If the government finds it impossible or inconvenient to furnish this important, and perhaps determinative, information in time for proper consideration at oral argument, we hope that in justice the government will join in the Trustee's view that the issue of proof is one properly to be considered by the Tax Court on remand, a procedure that would give the government ample time in which to develop and present this important information and would give the Trustee ample time in which to review and comment upon the government's submission.

Very truly yours,


Martin D. Ginsburg

APPENDIX C

INTERNAL REVENUE CODE OF 1954Section 453(a)Section 453. INSTALLMENT METHOD.

(a) DEALERS IN PERSONAL PROPERTY.--

(1) In General.--Under regulations prescribed by the secretary or his delegate, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.

(2) Total Contract Price.--For purposes of paragraph (1), the total contract price of all sales of personal property on the installment plan includes the amount of carrying charges or interest which is determined with respect to such sales and is added on the books of account of the seller to the established cash selling price of such property. This paragraph shall not apply with respect to sales of personal property under a revolving credit type plan or with respect to sales or other dispositions of property the income from which is, under subsection (b), returned on the basis and in the manner prescribed in paragraph (1).

Section 453(e)

(e) CARRYING CHARGES NOT INCLUDED IN TOTAL CONTRACT PRICE.--If the carrying charges or interest with respect to sales of personal property, the income from which is returned under subsection (a)(1), is not included in the total contract price, payments received with respect to such sales shall be treated as applying first against such carrying charges or interest. This subsection shall not apply with respect to sales or other dispositions of property the income from which is, under subsection (b), returned on the basis and in the manner prescribed in subsection (a)(1).

PERTINENT TREASURY REGULATIONS¶1(f) [Regulations, §1.453-1(f)]

(f) *Records.* In adopting the installment method of accounting the seller must maintain such records as are necessary to clearly reflect income in accordance with this section, section 446 and § 1.446-1.

¶2(d) [Regulations, §1.453-2(d)]

(d) *Revolving credit plans.* (1) To the extent provided in this paragraph, sales under a revolving credit plan will be treated as sales on the installment plan. The term "revolving credit plan" includes cycle budget accounts, flexible budget accounts, continuous budget accounts, and other similar plans or arrangements for the sale of personal property under which the customer agrees to pay each billing-month (as defined in subparagraph (6)(iii) of this paragraph) a part of the outstanding balance of his account. Sales under a revolving credit plan do not constitute sales on the installment plan merely

by reason of the fact that the total debt at the end of a billing-month is paid in installments. The terms and conditions of a revolving credit plan do not contemplate that each sale under the plan will be paid for in two or more payments and thus do not meet the requirements of paragraph (b)(1) of this section. In addition, since under a revolving credit plan payments are not generally applied to liquidate any particular sale, and since the terms and conditions of such plan contemplate that account balances may be paid in full or in installments, it is generally impossible to determine that a particular sale under a revolving credit plan is to be or is in fact paid for in installments so as to meet the requirements of paragraph (b)(2) of this section. However, subparagraphs (2) and (3) of this paragraph provide rules under which a certain percentage of charges under a revolving credit plan will be treated as sales on the installment plan. For purposes of arriving at this percentage, these rules, in general, treat as sales on the installment plan those sales under a revolving credit plan (1) which are of the type which the terms and conditions of the plan contemplate will be paid for in two or more installments and (2) which are charged to accounts on which subsequent payments indicate that such sales are being paid for in two or more installments.

(2)(i) The percentage of charges under a revolving credit plan which will be treated as sales on the installment plan shall be computed by making an actual segregation of charges in a probability sample of the revolving credit accounts and by applying the rules contained in subparagraph (3) of this paragraph to determine what percentage of charges in the sample is to be treated as sales on the installment plan. (See subparagraph (5) of this paragraph for rules to be used if some of the sales under a revolving credit plan are nonpersonal property sales (as defined in subparagraph (6)(iv) of this paragraph).) Such segregation shall be made of charges which make up the balances in the sample accounts as of the end of each customer's last billing-month ending within the taxable year. (See subparagraph (6)(v) of this paragraph for rules to be used in determining which charges make up the balance of an account.) However, in making such segregation, any account to which a sale is charged during the taxable year on which no payment is credited after the billing-month within which the sale is made (hereinafter called the "billing-month of sale") and on or before the end of the first billing-month ending in the taxpayer's next taxable year shall be disregarded and not taken into account in the determination of what percentage of charges in the sample is to be treated as sales on the installment plan. In order to obtain a probability sample, the accounts shall be selected in accordance with generally accepted probability sampling techniques. The appropriateness of the sampling technique and the accuracy and reliability of the results obtained must, if requested, be demonstrated to the satisfaction of the district director. If the district director is not satisfied that the taxpayer's sample is appropriate or that the results obtained are accurate and reliable, the taxpayer shall recompute his sample percentage or make appropriate adjustments to his original computations in a manner satisfactory to the district director. The taxpayer shall maintain records in sufficient detail to show the method of computing and applying the sample.

(ii) For taxable years ending before January 31, 1964, a taxpayer who has reported for income tax purposes all or a portion of sales under a revolving credit plan as sales on the installment method may apply the percentage obtained for the first taxable year ending on or after such date in determining the percentage of charges under a revolving credit plan for such prior taxable year (or years) which will be treated as sales on the installment plan. However, in computing the percentage to be applied in determining

the percentage of charges under a revolving credit plan which will be treated as sales on the installment plan for such prior taxable year (or years), the rule stated in paragraph (c)(3) of this section shall not apply. See subparagraph (6)(v) of this paragraph for rules relating to the application of payments to finance charges for such prior taxable years.

(3) For the purpose of determining the percentage described in subparagraph (2) of this paragraph, a charge under a revolving credit plan will be treated as a sale on the installment plan only if such charge is a sale (as defined in subparagraph (6)(i) of this paragraph) and meets the requirements contained in subdivisions (i) and (ii) of this subparagraph.

(i) The sale must be of the type which the terms and conditions of the plan contemplate will be paid for in two or more installments. If the aggregate of sales charged during a billing-month to an account under a revolving credit plan exceeds the required monthly payment, then all sales during such billing-month shall be considered to be of the type which the terms and conditions of such plan contemplate will be paid for in two or more installments. The required monthly payment shall be the amount of the payment which the terms and conditions of the revolving credit contract require the customer to make with respect to a billing-month. If the amount of such payment is not fixed at the date the contract is entered into, but is dependent upon the balance of the account, then such amount shall be the amount that the customer is required to pay (but not including any past-due payments) as shown on the statement either (a) for the last billing-month ending within the taxpayer's taxable year or (b) for the billing-month of sale, whichever method the taxpayer adopts for all his accounts. A taxpayer shall not change such method of determining the required monthly payment based upon the balance of the account without obtaining the consent of the district director. In any case where the required monthly payment is not set in accordance with a consistent method used during the entire taxable year, the district director may determine the required monthly payment in accordance with the method used during the major portion of such taxable year if he determines that the use of such method is necessary in order to reflect properly the income from sales under a revolving credit plan. The requirements stated in this subdivision may be illustrated by the following examples:

Example (1). Under the terms of a revolving credit plan the required monthly payment to be made by customer A is \$20. During the billing-month ending in December, sales aggregating \$80 are charged to customer A's account, and during the next billing-month, ending in January, sales aggregating \$19.95 and finance charges of \$.60 are charged to A's account. Since the aggregate of sales charged to customer A's account during the billing-month ending in December (\$80) exceeds the required monthly payment (\$20), the terms and conditions of the plan contemplate that the sales charged during such billing-month are of the type which will be paid for in two or more installments. Since the aggregate of sales charged to customer A's account during the billing-month ending in January (\$19.95) does not exceed the required monthly payment, the sales making up the aggregate of sales in such billing-month are not of the type which the terms and conditions of the plan contemplate will be paid for in two or more installments.

Example (2). The terms of a revolving credit plan require a payment of 20 percent of the balance of the customer's account as of the end of the billing-month for which the statement is rendered. A customer makes purchases aggregating \$25 in his next to the last billing-month ending within the taxpayer's taxable year, and the balance at the end of that month is \$150.

At the end of the customer's last billing-month ending within the taxpayer's taxable year, the balance of the account has decreased to \$110. If the taxpayer determines the required monthly payment by reference to the payment required on the statement for the last billing-month ending within the taxable year and applies such method consistently to all accounts, then the sales making up the \$25 aggregate of sales are of the type which the terms and conditions of the plan contemplate will be paid for in two or more installments. Although such aggregate was less than the \$30 payment ($20\% \times \150) required on the statement rendered for the billing-month of sale, it was more than the \$22 ($20\% \times \110) that the customer was required to pay on the statement rendered for his last billing-month ending within the taxable year, and thus meets the requirements of this subdivision. If, however, the taxpayer determines the required monthly payment by reference to the payment required on the statement for the billing-month of sale, then the sales making up the aggregate of sales during such billing-month do not meet the requirements of this subdivision because such aggregate was less than the \$30 payment required on the statement rendered for such month.

(ii) The sale must be charged to an account on which the first payment after the billing-month of sale indicates that the sale is being paid in installments. The first payment after the billing-month of sale indicates that the sale is being paid in installments if, and only if, such payment is an amount which is less than the balance of the account as of the close of the billing-month of sale. For purposes of this subdivision, such balance shall be reduced by any return or allowance credited to the account after the close of the billing-month of sale and before the close of the billing-month within which the first payment after the billing-month of sale is credited to the account, unless the taxpayer demonstrates that the return or allowance was attributable to a charge made in a month subsequent to the billing-month of sale. The requirements stated in this subdivision may be illustrated by the following examples, in which it is assumed that the taxpayer's annual accounting period ends on January 31.

Example (1). Customer A's revolving credit account shows the following sales and payments:

Month ending	Aggregate sales in month	Payments	Balance
Dec. 20	\$150	0	\$150
Jan. 20	75	\$ 30	195
Feb. 20	0	195	0

All sales made in the billing-month ending December 20 meet the requirements of this subdivision because the first payment on the account after such billing-month (\$30) was less than the balance of the account as of the close of such billing-month (\$150); and none of the sales made in the billing-month ending January 20 meets the requirements of this subdivision because the balance of the account as of the end of such billing-month was liquidated in one payment. By application of the rules of subparagraph (6)(v) of this paragraph, the balance in the account as of the last billing-month ending in the taxable year (\$195) consists of \$120 of the \$150 of sales made in the billing-month ending December 20 and all of the \$75 of sales made in the billing-month ending January 20. Therefore, \$120 of the account balance meets the requirements of this subdivision and \$75 does not.

Example (2). Customer B's revolving credit account shows the following sales and payments:

Month ending	Aggregate sales in month	Payments	Balance
Dec. 20	\$ 50	0	\$ 50
Jan. 20	-100	0	-150
Feb. 20	0	\$50	100

None of the sales made in the billing-month ending December 20 meets the requirements of this subdivision because the first payment credited to the account after such billing-month (\$50) is not less than the balance of the account as of the close of such month (\$50). All of the sales made in the billing-month ending January 20 meet the requirements of this subdivision because the first payment after such billing-month (\$50) is less than the balance of the account as of the close of such month (\$150).

Example (3). Customer C's revolving credit account shows the following purchases and credits:

Month ending	Item	Charges	Credits	Balance
Jan. 20	Coat	\$55		
	Dress	40		
	Shirt	5		\$100
Feb. 20	Return		\$ 5	
	Payment		95	0

None of the sales made in the billing-month ending January 20 meets the requirements of this subdivision because the first payment credited to the account after such billing-month (\$95) was equal to the balance of the account as of the end of such billing-month, \$95. For this purpose, the balance of \$100 is reduced by the \$5 return which was credited to the account after the close of the billing-month of sale and before the close of the billing-month within which the first payment after the billing-month of sale is credited.

(4) The provisions of subparagraphs (2) and (3) of this paragraph may be illustrated by the following examples in which it is assumed that the taxpayer is a dealer in personal property whose annual accounting period ends on January 31.

Example (1). Customer A's revolving credit ledger account shows the following:

Month ending	Aggregate sales in month*	Returns and allowances	Payments	Finance charges	Balance
Jan. 20	\$15.00	0	0	0	\$15.00
Feb. 20	0	0	0	\$0.15	15.15

* Including sales of personal property and nonpersonal property sales. For purposes of the segregation provided for in subparagraph (2)(i) of this paragraph, customer A's account will be disregarded and not taken into account in the determination of what percentage of charges in the sample is to be treated as sales on the installment plan because no payment was credited to that account after the billing-month of sale and on or before February 20.

Example (2). This example is applicable with respect to sales made during taxable years beginning before January 1, 1964. Under the terms of the taxpayer's revolving credit plan, payments are required in accordance with the following schedule:

Unpaid balance	Required monthly payment
0—\$ 99.99	\$20
\$100— 199.99	40
200— 299.99	60

Customer B's revolving credit ledger account for the period beginning on September 21, 1963 and ending February 20, 1964 shows the following:

Month ending	Aggregate sales in month *	Returns and allowances	Payments	Finance charges	Balance
Oct. 20	\$55.00	0	0	0	\$55.00
Nov. 20	45.00	0	\$20.00	\$.35	80.35
Dec. 20	20.00	0	20.00	.60	80.95
Jan. 20	26.00	\$ 5.00	20.00	.61	82.56
Feb. 20	0	10.00	72.56	0	0

* Including sales of personal property and nonpersonal property sales.

The three \$20 payments and the \$5 return or allowance made in the billing-months ending in the taxable year are applied, under the rules in subparagraph (6)(v), to liquidate the earliest outstanding charges, first to the \$55 aggregate of sales in the billing-month ending October 20 and next to \$10 of the aggregate of sales made in the billing-month ending November 20. Thus, the balance of the account as of the close of the billing-month ending January 20, \$82.56, is made up as follows:

Remainder of sales in billing-month ending Nov. 20 (\$45 — \$10) ..	\$35.00
Finance charge for billing-month ending Nov. 2035
Sales for billing-month ending Dec. 20	20.00
Finance charge for billing-month ending Dec. 2060
Sales for billing-month ending Jan. 20	26.00
Finance charge for billing-month ending Jan. 2061
	<u>\$82.56</u>

The sales of \$35 remaining from the aggregate of sales for the billing-month ending November 20 meet the requirements of subparagraph (3)(i) of this paragraph because the aggregate of sales charged during such billing-month (\$45) exceeds the required monthly payment (\$20), and such sales meet the requirements of subparagraph (3)(ii) of this paragraph because the first payment after the billing-month of sale (\$20) is an amount less than the balance of the account as of the close of such month (\$80.35). Therefore, \$35 of sales will be treated as sales on the installment plan. The \$20 aggregate of sales charged during the billing-month ending December 20 does not meet the requirements of subparagraph (3)(i) of this paragraph because it is in an amount which does not exceed the required monthly payment (\$20). (The finance charge of \$.60 added in the billing-month does not enter into the determination of the aggregate of sales for the month because the term "sales" (as defined in subparagraph (6)(i) of this paragraph) does not include finance charges). The \$26 aggregate of sales for the billing-month ending January 20 does not meet the requirements of subparagraph (3)(ii) of this

paragraph because the first payment after such billing-month (\$72.56) was equal to the balance of the account as of the close of such billing-month (\$72.56). For this purpose, the balance of \$82.56 is reduced by the \$10 return or allowance which was credited after the billing-month of sale and before February 20. Thus, of the \$82.56 balance of B's account as of the close of the last billing-month ending within corporation X's taxable year, \$35 will be treated as sales on the installment plan for purposes of determining the percentage provided for in subparagraph (2) of this paragraph.

Example (3). This example is applicable with respect to sales made during taxable years beginning after December 31, 1963. Assume the facts in example (2), except that Customer B's revolving credit ledger account is for the period beginning on September 21, 1964 and ending February 20, 1965. Since payments received are first used to liquidate any outstanding finance charges under the rule in subparagraph (6)(v), the \$20 payment in December liquidated the \$.35 finance charge accrued at the end of the November billing-month and the \$20 payment in January liquidated the \$.60 finance charge accrued at the end of the December billing-month. The balance of the three \$20 payments (\$59.05) and the \$5 return or allowance are applied (under the rules in subparagraph (6)(v)) to liquidate the earliest outstanding sales, first to the \$55 aggregate of sales in the billing-month ending October 20 and next to \$9.05 of the aggregate of sales made in the billing-month ending November 20. Thus, the balance of the account as of the close of the billing-month ending January 20, \$82.56, is made up as follows:

Remainder of sales in billing-month ending Nov. 20 (\$45 — \$9.05)	\$35.95
Sales for billing-month ending Dec. 20	20.00
Sales for billing-month ending Jan. 20	26.00
Finance charge for billing-month ending Jan. 2061
	<hr/>
	\$82.56

The sales of \$35.95 remaining from the aggregate of sales for the billing-month ending November 20 meet the requirements of subparagraph (3)(i) of this paragraph because the aggregate of sales charged during such billing-month (\$45) exceeds the required monthly payment (\$20), and such sales meet the requirements of subparagraph (3)(ii) of this paragraph because the first payment after the billing-month of sale (\$20) is an amount less than the balance of the account as of the close of such month (\$80.35). Therefore, \$35.95 of sales will be treated as sales on the installment plan. The \$20 aggregate of sales charged during the billing-month ending December 20 does not meet the requirements of subparagraph (3)(i) of this paragraph because it is in an amount which does not exceed the required monthly payment (\$20). The \$26 aggregate of sales for the billing-month ending January 20 does not meet the requirements of subparagraph (3)(ii) of this paragraph because the first payment after such billing-month (\$72.56) was equal to the balance of the account as of the close of such billing-month (\$72.56). For this purpose, the balance of \$82.56 is reduced by the \$10 return or allowance which was credited after the billing-month of sale and before February 20. Thus, of the \$82.56 balance of B's account as of the close of the last billing-month ending within corporation X's taxable year, \$35.95 will be treated as sales on the installment plan for purposes of determining the percentage provided for in subparagraph (2) of this paragraph.

(5) Sales under a revolving credit plan which are nonpersonal property sales (as defined in subparagraph (6)(iv) of this paragraph) do not constitute sales on the installment plan. Therefore, the charges under a revolving credit

plan must be reduced by the nonpersonal property sales, if any, under such plan, before application of the sample percentage as provided for in subparagraph (2)(i) of this paragraph. The taxpayer may treat as the nonpersonal property sales under the plan for the taxable year an amount which bears the same ratio to the total sales under the revolving credit plan made in the taxable year as the total nonpersonal property sales made in such year bears to the total sales made in such year.

(6) For purposes of this paragraph—

(i) The term "sales" includes sales of services, such as a charge for watch repair, as well as sales of property, but does not include finance or service charges.

(ii) The term "charges" includes sales of services and property as well as finance or service charges.

(iii) A billing-month is that period of time for which a periodic statement of charges and credits is rendered to a customer.

(iv) The term "nonpersonal property sales" means all sales which are not sales of personal property made by the taxpayer. Thus, sales of a department leased by the taxpayer to another are nonpersonal property sales. Likewise, charges for services rendered by the taxpayer are nonpersonal property sales unless such services are incidental to and rendered contemporaneously with the sale of personal property, in which case such charges shall be considered as constituting part of the selling price of such property.

(v) Except as otherwise provided in this subdivision, each payment received from a customer under a revolving credit plan before the close of the last billing-month ending in the taxable year shall be applied to liquidate the earliest outstanding charges under such plan, notwithstanding any rule of law or contract provision to the contrary. For purposes of determining which charges remain in the balance of an account at the end of the last billing-month ending in the taxable year, the taxpayer may apply returns and allowances which are credited before the close of the last billing-month ending in the taxable year either (a) to liquidate or reduce the charge for the specific item so returned or for which an allowance is permitted, or (b) to liquidate or reduce the earliest outstanding charges. The method so selected for applying returns and allowances shall be followed on a consistent basis from year to year unless the district director consents to a change. Additionally, finance or service charges which are computed on the basis of the balance of the account at the end of the previous billing-month (usually reduced by payments during the current billing-month) are accrued at the end of the current billing-month and are therefore considered, for purposes of determining the earliest outstanding charges, as charged to the account after any sales made during the current billing-month. However, for purposes of determining which charges remain in the balance of an account at the end of the last billing-month ending in a taxable year which began after December 31, 1963, payments received during such year shall be applied first against any finance or service charges which were outstanding at the time such payment was received. The preceding sentence shall not apply with respect to a computation made for purposes of applying the rule described in subparagraph (2)(ii) of this paragraph.

(vi) The taxpayer shall allocate those sales under a revolving credit plan which are treated as sales on the installment plan to the proper year of sale in order to apply the appropriate gross profit percentage as provided for in paragraph (c) of this section. This allocation shall be made on the

basis of the percentages of charges treated as sales on the installment plan which are attributable to each taxable year as determined in the sample of accounts described in subparagraph (2) of this paragraph. However, if the taxpayer demonstrates to the satisfaction of the district director that income from sales on the installment plan is clearly reflected, all sales may be considered as being made in the taxable year for purposes of applying the gross profit percentage.

(7) The provisions of this paragraph may be illustrated by the following example:

Example. Corporation X is a dealer in personal property and has elected to report on the installment method those sales under its revolving credit plan which may be treated as sales on the installment plan. Corporation X's taxable year ends on January 31, and the total balance of all its revolving credit accounts as of January 31, 1964, is \$2,000,000. The total sales made in the taxable year are \$10,000,000 of which \$500,000 are nonpersonal property sales. The gross profit percentage realized or to be realized on all sales made in the taxable year is 40 percent. The amount of the gross profit contained in the year-end balance of \$2,000,000 which may be deferred to succeeding years is computed as follows:

(i) In order to reduce the charges appearing in the year-end balance of revolving credit accounts receivable by the nonpersonal property sales contained therein, corporation X determines the amount of such nonpersonal property sales under the method permitted in subparagraph (5) of this paragraph. Corporation X first determines the ratio which total nonpersonal property sales made during the year (\$500,000) bears to total sales made during the year (\$10,000,000), and then applies the percentage (5%) thus obtained to the year-end balance of revolving credit accounts receivable (\$2,000,000). The nonpersonal property sales thus determined (\$100,000) is subtracted from such year-end balance to obtain the charges under the revolving credit plan appearing in the year-end balance (\$1,900,000) to which the sample percentage is to be applied.

(ii) In accordance with generally accepted sampling techniques, the taxpayer selects a probability sample of all revolving credit accounts having balances for billing-months ending in January 1964. The technique employed results in a random selection of accounts with total balances of \$100,000.

(iii) Analysis of these sample accounts discloses that of the \$100,000 of balances, \$10,000 of balances are in accounts on which no payment was credited after a billing-month of sale and on or before the end of the first billing-month ending in the taxable year beginning February 1, 1964. These balances are, therefore, disregarded and not taken into account in the determination of what percentage of sales in the sample is to be treated as sales on the installment plan. Of the remaining \$90,000 of balances, the taxpayer determines, by analyzing the ledger cards in the sample, that \$63,000 of balances are composed of sales which meet the requirements of subparagraph (3)(i) and (ii) of this paragraph and are thus treated as sales on the installment plan. The remaining \$27,000 of balances either did not meet the requirements of subparagraph (3)(i) or (ii) of this paragraph or were not sales (as defined in subparagraph (6)(i) of this paragraph). The percentage of charges in the sample treated as sales on the installment plan is, therefore, 70 percent ($\$63,000 \div \$90,000$).

(iv) The charges in the year-end balance which are to be treated as sales on the installment plan, \$1,330,000, are computed by multiplying the

charges determined in subdivision (i) of this subparagraph (\$1,900,000) by the percentage obtained in subdivision (iii) of this subparagraph (70%).

(v) The deferred gross profit attributable to sales under the revolving credit plan for the taxable year, \$532,000, is determined by multiplying the amount determined in subdivision (iv) of this subparagraph, \$1,330,000, by the gross profit percentage, 40%. (Corporation X will be able to demonstrate to the satisfaction of the district director that (a) since the gross profit percentage for all sales does not vary materially from the gross profit percentage for all sales made under the revolving credit plan, (b) since only an insubstantial amount of sales included in year-end account balances was made prior to the taxable year, and (c) since the prior year's gross profit percentage does not vary materially from the gross profit percentage for the taxable year, income from sales on the installment plan will be clearly reflected by applying the current year's gross profit percentage for all sales under the revolving credit plan created as sales on the installment plan.)

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

-----X
CHARLES G. RODMAN, as Trustee
of the ESTATE OF W. T. GRANT
COMPANY, Bankrupt

: Docket No.
75 4214
:

Petitioner-Appellant, :

v.

COMMISSIONER OF INTERNAL REVENUE, :

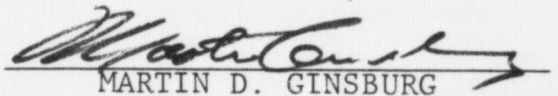
Respondent-Appellee. :

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STATE OF NEW YORK)
COUNTY OF NEW YORK) ss.:
)

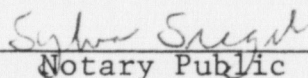
MARTIN D. GINSBURG, being duly sworn, deposes and
says:

1. That he is not a party to the action, is
over 18 years of age and resides at 150 East 69th Street,
New York, New York.

2. That on the 17th day of December, 1976 he served
three copies of the within Reply Brief on Appeal upon Joseph L.
Liegl, Esq., Tax Division, Department of Justice, Washington,
D.C. 20530, attorney for the Respondent-Appellee by depositing
same enclosed in a postpaid properly addressed wrapper, in
an official depository under the exclusive care and custody
of the United States post office department within the State
of New York.


MARTIN D. GINSBURG

Sworn to before me this
17th day of December, 1976.


Notary Public

SYLVIA SIEGEL
Notary Public, State of New York
No. 8990010
Qualified in Kings County
Commission Expires March 30, 1978

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

CHARLES G. RODMAN, as Trustee
of the ESTATE OF W. T. GRANT
COMPANY, Bankrupt,

Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL
REVENUE,

Respondent-Appellee.

AFFIDAVIT OF SERVICE

WEIL, GOTSHAL & MANGES

Attorneys for Petitioner-Appellant

Office and Post Office Address, Telephone

767 FIFTH AVENUE

Borough of Manhattan New York, N.Y. 10022

PLAZA 8-7800

To

Attorney for

Service of a certified copy of the within

is hereby admitted.

Dated,

Attorney for
